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FISCAL IMPACT STATEMENT

LS 7600

BILL NUMBER: SB 449

NOTE PREPARED: Jan 8, 2007

BILL AMENDED:

SUBJECT: Taxation of Civil Service Annuities.

FIRST AUTHOR: Sen. Landske

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL**
 X **DEDICATED**
 FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill increases the civil service annuity deduction from \$2,000 to \$10,000 over a seven year phase-in period and provides that the deduction is available to a surviving spouse.

Effective Date: January 1, 2007 (retroactive).

Explanation of State Expenditures:

Explanation of State Revenues: *Summary:* The bill would reduce Adjusted Gross Income (AGI) Tax liabilities of certain individual taxpayers who receive federal civil service retirement benefits and currently claim the maximum \$2,000 deduction for this income. The bill phases-in an increase in the deduction from \$2,000 to \$10,000 over 7 years. The potential revenue loss due to the increase in the deduction is summarized in the table below.

Tax Year	Maximum Deduction	Annual Revenue Loss
2007 and 2008	\$4,000	\$218,000
2009 and 2010	\$6,000	\$425,000
2011 and 2012	\$8,000	\$621,000
2013 and after	\$10,000	\$808,000

The fiscal year impact of the deduction increase would begin in FY 2008. If recent trends persist, the annual revenue loss after the phase-in is complete could potentially decline by about 1.2%. The impact of extending the deduction to a surviving spouse could potentially increase the revenue loss from the bill, but the extent of the impact is unknown.

Background Information: Under current statute, taxpayers may deduct up to \$2,000 in civil service annuity income. The deduction is equal to the difference between \$2,000 and the total amount of social security and railroad benefits received by the taxpayer. State tax return data indicates that 4,159 taxpayers deducted approximately \$7.3 M in civil service annuity pay from AGI in 2004. This amount resulted in a revenue loss of about \$250,000. From 2000 to 2004, this deduction declined by an average of 1.2% per year. Data from the U.S. Office of Personnel Management indicates that there were about 26,000 federal retirees and about 8,800 surviving spouses of federal retirees residing in Indiana in 2006. These individuals received \$740.0 M in civil service annuity payments during 2006, with the average annuity to retirees equal to about \$24,000. The average survivor's benefit was about \$13,000.

It is assumed that taxpayers currently claiming the maximum deduction do not receive social security or railroad retirement benefits. Based on the average benefits cited above, it is also assumed that these taxpayers would also be able to claim the maximum deductions established in the bill. In 2004, 3,228 taxpayers claimed the maximum deduction, with 96 claiming a \$4,000 deduction on joint returns. This total has declined by about 1.8% annually since 2000.

The bill increases the deduction beginning in tax year 2007, thus, the fiscal impact of the phase-in will commence in FY 2008. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the increase in the civil service retirement deduction would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) could potentially experience a minimal decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: OFMA Income Tax databases, 1996-2004; Ed Callicott, Federal Office of Personnel Management, (202) 606-0650; Ellen Holmes, Federal Office of Personnel Management, (202) 606-1782.

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